



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

Number: **200831035**  
Release Date: 8/1/2008

Date: May 9, 2008

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

SE:T:EO:RA:T:3

UIL:  
4941.00-00

Legend:

Benefit Fund A =  
Union =  
Benefit Fund B =

Dear :

We have considered your ruling request dated March 14, 2008, concerning the federal income and excise tax consequences under sections 507, 4941, and 4946 of the Internal Revenue Code of 1986, as amended (hereafter "Code"), related to a proposed transfer of assets, in the manner and for the purposes described below.

Facts:

You have represented the following facts. You have been recognized as an organization exempt under section 501(c)(3) of the Code and classified as a private foundation within the meaning of section 509(a). Benefit Fund A is an employee benefit plan within the meaning of section 3(3) of the Employee Retirement Income Security Act of 1974, as amended (hereafter "ERISA"), and an employee welfare benefit plan within the meaning of ERISA section 3(1). Union is the plan sponsor of Benefit Fund A, within the meaning of ERISA section 16(B)(2). Benefit Fund A's assets are comprised of contributions from Union employers, Union employees, other employee benefit plans in which Union members have participated, and earnings thereon. There are no longer any contributions being made to Benefit Fund A. Benefit Fund A provides death benefits to the beneficiaries of deceased members and retired members of Union. Benefit Fund A is not a separate entity from Union for Federal income tax purposes and the income earned on its assets is exempt from Federal income tax under section 501(c)(5).

Union's Benefit Committee, acting as the named beneficiary of Benefit Fund A, proposed an amendment that provided that if Benefit Fund A was terminated the proceeds would be used for various purposes, including any purpose deemed appropriate by Union's General Executive

Board. Union's General Executive Board, through its authority as sponsor of Benefit Fund A, passed a resolution providing for both the termination of Benefit Fund A and the near-simultaneous creation of Benefit Fund B, which was established as a successor to Benefit Fund A. Pursuant to this resolution, approximately                      dollars was transferred from Benefit Fund A to Union, "and all other assets and liabilities to a successor fund [Benefit Fund B] with the same name, trustees, plan administrator, participants, beneficiaries, purpose and substantially the same benefits as the Fund [Benefit Fund A]". This same resolution was approved with the exception that approximately                      dollars of these funds would later be transferred to you.

As a result of this transfer, a class action lawsuit was instituted in federal district court by participants in and beneficiaries of Benefit Fund A against you, Benefit Fund A, Benefit Fund B, and several defendants named individually. Pursuant to the filed Summons and Complaint, some of the persons individually named in the complaint as defendants were at certain times fiduciaries of several entities including Union's Benefit Committee, Union's General Executive Board, Benefit Fund A and Benefit Fund B. Furthermore, these individually named defendants were, as to you, foundation managers and fiduciaries, and one of them still is. The Summons and Complaint alleged that the above referenced parties violated their fiduciary duties under ERISA by their transference of approximately                      dollars out of Benefit Fund A and their subsequent termination of Benefit Fund A.

Litigation over this matter has ensued for over    years, with neither side achieving a favorable ruling on the merits of their position. You represent that through court intervention to settle this matter, it appeared to the parties that neither side had better than a 50/50 chance of prevailing on the merits, with any potential decision by the court being an all or nothing proposition. In order to avoid the continued expense and hardship of litigation, through the aid of judicial intervention the litigants agreed to settle this matter.

In                      , the first of two agreements to settle the ongoing litigation was entered into by all parties except for you. All defendants, including you, were represented by the same counsel from commencement of the legal action through the beginning of these negotiations. After months of negotiations, you sought views from outside counsel, who advised that your litigation position was superior to that of the other defendants and that the terms offered you were inferior to those offered to the other defendants. New, independent counsel retained by you was unable to reach terms that your board considered in your best interests. The                      Settlement Agreement indemnified the defendants for their alleged breach of ERISA fiduciary duties related to the transfer of all assets out of Fund A and the subsequent termination of Fund A. The Settlement Agreement was approved by the presiding federal district court in                      , over the objections of your counsel.

Approval of that partial settlement put pressure on you, as the only remaining defendant, to settle the lawsuit. Motions by the remaining parties for summary judgment were denied by the court, which also dismissed a number of your defenses.

A second settlement agreement was entered into by Class Counsel (on behalf of plaintiffs) and by you, as the sole remaining defendant. This                      Settlement Agreement was preliminarily approved by the court pending (a) the court's ultimate determination after a fairness hearing and (b) issuance of a favorable letter ruling by the IRS. The                      Settlement Agreement provides for the establishment of a Settlement Account that would be funded with an

approximate                      dollar payment from you. You state that this amount represents just under half of the amount transferred from Benefit Fund A to you, and just about half of your net assets at the time of settlement. The                      Settlement Agreement provides the following:

1. An approximate                      dollar payment to the Settlement Account, plus any interest accrued thereon, less (i) the cost of giving notice to participants, (ii) whatever legal fees and costs are awarded to Class Counsel by the court, (iii) any interest accruing to the Settlement Account on those fees and costs and (iv) taxes imposed, is to be paid to Benefit Fund B to provide additional benefits to the beneficiaries of the participants; and,
2. Any and all claims arising from the facts and events stated in support of plaintiffs' claim could no longer be used by any member of the Class to support a claim against you and any of your directors, officers, employees, agents or attorneys.

The experienced judge who mediated the final settlement negotiations, after extensive negotiations in his presence, recommended that both parties settle the case on the terms reflected in a memorandum of understanding that resolved all major issues between the parties and with minor modifications became the                      Settlement Agreement. Your independent litigation counsel and your independent tax counsel both advise that the proposed settlement is in your best interests.

You have requested the following rulings:

1. Payment by you of approximately                      dollars to Benefit Fund B will not constitute an act of self-dealing under section 4941 of the Code for you and any of your directors, officers, employees, agents or attorneys in reference to this payment.
2. Payment by you of approximately                      dollars to Benefit Fund B will not constitute a taxable expenditure under section 4945(d) of the Code in reference to this payment.
3. Payment by you of approximately                      dollars to Benefit Fund B is not a Transfer described in section 507(a) of the Code so that your private foundation status will not be terminated under this provision and no termination tax will be imposed under section 507(c).

Law:

Section 507(a)(1) of the Code provides that the status of any organization as a private foundation shall be terminated only if it notifies the Secretary of its intent to accomplish a termination or there have been either willful repeated acts (or failures to act), or a willful flagrant act (or failure to act) giving rise to chapter 42 liability for tax and the Secretary notifies such organization that it is liable for the tax imposed by subsection (c) and either such organization pays the tax or pays any portion not abated under subsection (g).

Section 507(b)(2) of the Code provides that in the case of a transfer of assets of any private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization or reorganization, the transferee foundation shall not be treated as a newly created organization.

Section 507(c) of the Code imposes a termination tax equal to certain defined amounts,

which are generally the lower of the "aggregate tax benefit" resulting from the tax exempt status or the fair market value of the assets.

Section 4941(a)(1) of the Code imposes an excise tax on each act of self-dealing between a disqualified person and a private foundation.

Section 4941(a)(2) of the Code imposes an excise tax on the participation of a foundation manager in an act of self-dealing between a disqualified person and a private foundation.

Section 4941(d)(1)(E) of the Code provides that the term "self-dealing" means any direct or indirect transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

Section 4945 of the Code imposes an excise tax on a private foundation's making of any taxable expenditure under section 4945(d).

Section 4945(d)(5) of the Code provides the term "taxable expenditure" means any amount paid or incurred by a private foundation for any purpose other than one specified in section 170(c)(2)(B).

Section 4946(a)(1) of the Code defines the term "disqualified person", with respect to a private foundation, to include a substantial contributor to the foundation, or a foundation manager.

Section 4946(a)(2) of the Code defines the term "substantial contributor", with reference to section 507(d)(2), as any contributor who "contributed or bequeathed an aggregate amount of more than \$5,000 to the private foundation, if such amount is more than 2 percent of the total contributions and bequests received by the foundation before the close of the taxable year of the foundation in which the contribution or bequest is received by the foundation from such person."

Section 1.507-3(a)(4) of the Federal Income Tax Regulations (hereafter "Regulations") provides that if a private foundation incurs liability for one or more of the taxes imposed under chapter 42 (or any penalty resulting therein) prior to, or as a result of, making a transfer of assets described in section 507(b)(2) of the Code to one or more private foundations, in any case where transferee liability applies each transferee foundation shall be treated as receiving the transferred assets subject to such liability to the extent that the transferor foundation does not satisfy such liability.

Section 1.507-3(c)(1) of the Regulations provides that as used in section 507(b)(2) of the Code, the term "other adjustment, organization or reorganization" shall include any partial liquidation or any other significant disposition of assets to one or more private foundations.

Section 53.4941(d)-2(f)(3) of the Foundation and Similar Excise Taxes Regulations (hereafter "Foundation Regulations") provides that, except as provided in section 53.4941(d)-3(c), section 4941(d)(1) of the Code shall not apply to the indemnification by a private foundation of a foundation manager, with respect to the manager's defense in any civil judicial or civil administrative proceeding arising out of the manager's performance of services (or failure

to perform services) on behalf of the foundation, against all expenses (other than taxes, including taxes imposed by Chapter 42, penalties, or expenses of correction) including attorneys' fees, judgments and settlement expenditures if (i) such expenses are reasonably incurred by the manager in connection with such proceeding; and (ii) the manager has not acted willfully and without reasonable cause with respect to the act or failure to act which led to such proceeding or to liability for tax under Chapter 42.

Section 53.4945-6(b)(2) of the Foundation Regulations provides that expenditures for unreasonable administrative expenses, including compensation, consultant fees, and other fees for services rendered, will ordinarily be taxable expenditures under section 4945(d)(5) of the Code unless the foundation can demonstrate that such expenses were paid or incurred in the good faith belief that they were reasonable and that the payment or incurrence of such expenses in such amounts was consistent with ordinary business care and prudence.

In Underwood v. United States, 461 F. Supp. 1382 (D.C. Texas 1978), plaintiff contributed monies to a law school on the condition that the contribution would be fully deductible by plaintiff. When it was determined by the IRS that a portion of contributions made by plaintiff to foundation established to facilitate plaintiff's contributions to law school were not so deductible, return by foundation to plaintiff of contribution not deductible was held by the District Court not to be an act of self-dealing within the meaning of section 4941 of the Code. The District Court held that "the return by the Foundation of the amount of those contributions which the Foundation should not have received and which it was not entitled to keep is not a 'transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation' within the meaning of section 4941(d)(1)(E) of the Code." Id at 1389.

Analysis:

Ruling 1:

The issue is whether pursuant to a preliminary court approved settlement agreement, the transfer of approximately                      dollars from you to Benefit Fund B and the indemnification of you and your directors, officers, employees, agents or attorneys in reference to this transfer, is or is not an act of self-dealing under section 4941 of the Code.

You are recognized as a private foundation under sections 501(c)(3) and 509(a) of the Code. Section 4941(a)(1) imposes an excise tax on each act of self-dealing between a private foundation and a disqualified person, with the definition of self-dealing including a direct or indirect transfer to, or use by or for the benefit of, a disqualified person, of the income or assets of a private foundation. Section 4946(a)(1)(A) provides that the term "disqualified person" with respect to a private foundation includes a substantial contributor.

Here Fund B is considered a substantial contributor to you and therefore a disqualified person. Fund A was a substantial contributor to you under section 4945(b)(1) of the Code as a result of the approximate                      dollar transfer. Fund A terminated and Fund B succeeded to all the assets and liabilities of Fund A, including the same name, trustees, plan administrator, participants, beneficiaries, purpose and substantially the same benefits as Fund A. As successor to Fund A, Fund B is considered a substantial contributor to you and therefore a disqualified person in reference to any proposed transfer of assets from you to Fund B.

We find that the settlement will not result in an act of self-dealing. In Underwood v. United States, 461 F. Supp. 1382 (D.C. Texas 1978), the Court decided the issue of whether section 4941(d)(1)(E) of the Code applied to a foundation's return to a substantial contributor of monies it received via the contributor's conditional gift. The Court held that "the return by the Foundation of the amount of those contributions which the Foundation should not have received and which it was not entitled to keep is not a "transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation" within the meaning of Section 4941(d)(1)(E) of the Code." Id at 1389. By analogy to Underwood, the proposed transfer of approximately                dollars from you to Fund B, pursuant to the                Settlement Agreement, represents the amount of money that you should not have received and which you are not entitled to keep. Specifically in Underwood, the foundation's right to the contributed money was based on a condition precedent that was not met, terminating foundation's legal right to the contributed money and requiring its return. Herein, you state that your legal right to the money transferred from Fund A is terminated by a condition subsequent, that condition being the court's                Settlement Agreement terminating your legal right to the money and requiring its return. As you are not the legal owner of these assets, the return of these assets to Fund B, as the successor legal owner, cannot be said to constitute a transfer of assets for a finding of self-dealing under section 4941(d)(1)(E).

Our finding is predicated on the settlement being in your best interests. As referenced fully above, vigorous litigation has ensued for over                years over the legality of the transfer from Fund A to you and Fund B. You represent that the                Settlement Agreement established the rights and liabilities of you and the other litigants. This was not a "friendly" action, and all parties were represented by competent legal counsel. There is no suggestion here of any collusion to benefit you or any other litigant. Your independent counsel represent that the settlement is in your best interests, and the judge mediating the settlement negotiations also recommended the settlement.

Because the                Settlement Agreement fairly establishes each litigant's rights and liabilities, you do not have any greater interest in the amount transferred from Fund A than the amount which you retain in the settlement.

Ruling 2:

The issue is whether pursuant to a preliminary court approved settlement agreement, the payment by you of approximately                dollars to Benefit Fund B will constitute a taxable expenditure under section 4945(d) of the Code.

Section 4945 of the Code imposes an excise tax on a private foundation's "taxable expenditures", which includes any amount paid or incurred by a private foundation for any purpose other than charitable purpose as defined under section 170(c)(2)(B). Section 53.4945-6(b)(2) of the Foundation Regulations provides that expenditures for unreasonable administrative expenses, including compensation, consultant fees, and other fees for services rendered, will ordinarily be "taxable expenditures" unless the foundation can demonstrate that such expenses were paid or incurred in the good faith belief that they were reasonable and that the payment or incurrence of such expenses in such amounts was consistent with ordinary business care and prudence.

The Court in Underwood v. United States, supra, also considered whether a foundation's

return of a conditional contribution was a taxable expenditure within the meaning of section 4945 of the Code. The Court stated that the amounts returned were assets that the foundation should not have received and which it was not entitled to keep. Such amounts were not considered an "amount paid or incurred by a private foundation" within the meaning of section 4945.

The Settlement Agreement settled the parties' right and liabilities arising out of the litigation. (See Ruling 1 for a complete discussion of this issue). The Settlement Agreement has been preliminarily approved by the court and is binding upon the parties as if the issues were fully litigated and judgment entered by the court accordingly. Under the rationale of Underwood, the payment by you of approximately                      dollars to Fund B under the terms of the settlement agreement is an amount that you are not legally entitled to keep and its return is not an amount paid or incurred by you. Alternatively, we regard the payment as an administrative expense which, under the circumstances, is reasonable. Therefore, the payment by you of approximately                      dollars will not be a "taxable expenditure" under section 4945 of the Code and 53.4945-6(b)(2) of the Foundation Regulations.

Ruling 3:

The issue is whether pursuant to a preliminary court approved settlement agreement, the payment by you of approximately                      dollars to Benefit Fund B is a transfer resulting in a taxable termination of your private foundation status under section 507(a) of the Code.

Under Section 507(a)(1) of the Code, an organization's private foundation status is terminated if it either notifies the Secretary of its intent to accomplish a termination or there have been either willful repeated acts (or failures to act), or a willful flagrant act (or failure to act) giving rise to chapter 42 tax liability. Section 507(c) of the Code imposes a termination tax equal to certain defined amounts, which are generally the lower of the "aggregate tax benefit" resulting from the tax exempt status or the fair market value of the assets.

You have not notified the Secretary of any intent to terminate your private foundation status. Nor are we aware of any acts giving rise to liability tax under Chapter 42 of the Code. As stated in Ruling 1 and Ruling 2, your payment of approximately                      dollars to Benefit Fund B pursuant to the 2008 Settlement Agreement does not give rise to taxation under sections 4941 and 4945 of the Code. Therefore, you are not liable for a termination tax under section 507(c) of the Code.

Accordingly, based upon the information submitted in your ruling request, we rule as follows:

1. Payment by you of approximately                      dollars to Benefit Fund B will not constitute an act of self-dealing under section 4941 of the Code for you and any of your directors, officers, employees, agents or attorneys in reference to this payment.
2. Payment by you of approximately                      dollars to Benefit Fund B will not constitute a taxable expenditure under section 4945(d) of the Code in reference to this payment.
3. Payment by you of approximately                      dollars to Benefit Fund B is not a Transfer described in section 507(a) of the Code so that your private foundation

status will not be terminated under this provision and no termination tax will be imposed under section 507(c).

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Robert C. Harper, Jr.  
Manager, Exempt Organizations  
Technical Group 3

Enclosure  
Notice 437